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Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

THOMAS H. THORNER, et. al.,
Cross-Petitioners,

VS.

WYNEMA ANNA CROSS, Executrix, et al.,
Cross-Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

CROSS-PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether Section 9(e) of the Securities Exchange Act of 1934 requires an investor to commence an action for violation of Section 10(b) within one year of actual discovery of the facts constituting the violation, as opposed to within one year of the date on which the investor, in the exercise of reasonable diligence, should have discovered the facts constituting the violation.

2. Whether, for purposes of the one-year limitations period of Section 9(e) of the Securities Exchange Act of 1934, a securities issuer's rescission offer implemented in settlement of an SEC enforcement action operates, as a matter of law, to put investors (including investors in subsequent separate securities offerings) on notice of a wholly distinct fraudulent scheme perpetrated by the issuer, where (a) the limited violations of law alleged by the SEC have seemingly been cured by the rescission offer prospectus, (b) no other evidence of fraud by the issuer is apparent, and (c) the jury specifically found that such investors did not discover and could not with reasonable diligence have discovered the fraud until 28 months later.

3. Whether the doctrine of equitable estoppel enunciated by this Court in *Glus v. Brooklyn Eastern District Terminal*, 359 U.S. 231 (1959), is inapplicable as a matter of law to cases subject to Section 9(e) of the Securities Exchange Act of 1934.

PARTIES TO THE PROCEEDING

Cross-petitioners are respondents to the petition herein. Cross-respondents are petitioners herein.

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On Petition for Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

CROSS-PETITION FOR A WRIT OF CERTIORARI

Cross-petitioners respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Tenth Circuit in this case prior to consideration by this Court of petitioners' challenge to the constitutionality of Section 27A of the Securities Exchange Act of 1934.

OPINIONS BELOW

The initial opinion of the court of appeals (App. 1a-50a[1]) is reported at 939 F.2d 1420, and the order denying cross-petitioners' motion for rehearing (App. 51a-55a) is reported at 947 F.2d 897. The opinion of the court of appeals on remand from this Court (App. 56a-95a) is reported at 977

[1] "App." refers to the separately bound appendix to the pending petition for a writ of certiorari in *William H. Dennler, et al. v. Robert S. Trippet, et al.*, No. 92-1003, filed December 11, 1992.

F.2d 1533. The opinion of the court of appeals denying in part and granting in part the motion for rehearing of cross-respondents (App. 98a-108a) is reported at 977 F.2d 1549. The order of the district court entered October 17, 1988 rejecting cross-respondents' statute of limitations defenses (App. 109a-111a) is unreported. The final judgment of the district court (excluding appendices thereto) entered November 16, 1989 (App. 112a-127a) is reported at [1989-90 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,970.

JURISDICTION

The petition for a writ of certiorari herein was received on December 24, 1992. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254. This cross-petition is timely under Supreme Court Rules 12.3 and 13.5.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Seventh Amendment to the United States Constitution; Sections 9(e), 10(b) and 27A(a) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78i(e), 78j(b) and 78aa-1(a); Section 13 of the Securities Act of 1933, 15 U.S.C. § 77m.

STATEMENT

1. This cross-petition seeks review of the same judgment of the Tenth Circuit which is the subject of cross-petitioners' pending Petition for a Writ of Certiorari in *William H. Dennler, et al. v. Robert S. Trippet, et al.*, No. 92-1003, filed December 11, 1992 (hereinafter "Dennler Petition"). Cross-petitioners incorporate herein by reference the Statement set forth therein at pages 2-12.

2. The court of appeals, in its first opinion (App. 1a-50a), as amended on rehearing (App. 51a-55a), reversed

cross-petitioners' judgments under Section 10(b) of the Securities Exchange Act of 1934 (the "1934 Act"), 15 U.S.C. § 78j(b), applying the limitations period in Section 9(e) of the 1934 Act, 15 U.S.C. § 78i(e), as announced in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, ___ U.S. ___, 111 S.Ct. 2773 (1991). The court of appeals' reasoning was substantially similar to the reasoning employed in reversing cross-petitioners' judgments under Section 11 of the Securities Act of 1933 (the "1933 Act"), 15 U.S.C. § 77k. *See* Dennler Petition at 9-10. Following enactment of Section 27A of the 1934 Act, 15 U.S.C. § 78aa-1, and remand by this Court, the court of appeals found (1) that cross-petitioners' Section 10(b) claims were timely under Section 27A,[2] and (2) that Section 27A is constitutional. Cross-respondents' petition for a writ of certiorari challenges, among other things, the constitutionality of Section 27A. Cross-petitioners have opposed that petition.

3. Were the Court to grant this cross-petition and rule in cross-petitioners' favor on the issue of equitable estoppel, consideration of the constitutionality of Section 27A would be avoided, since all Section 10(b) claims would be timely, regardless of whether the Court applied the limitations period contained in Section 27A or the limitations period in Section 9(e).

4. Were the Court to grant this cross-petition and affirm the jury's findings regarding the dates on which cross-petitioners discovered the facts constituting the violation of Section 10(b), the Section 10(b) claims of cross-petitioners in the 1970 through 1972 Classes would be timely regardless of the constitutionality of Section 27A.

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[2] The Tenth Circuit remanded the Section 10(b) claims of the 1971 Program class against cross-respondent Kothe & Eagleton for a further finding. (App. 100a-102a).

REASONS FOR GRANTING THE CROSS-PETITION

1. Prior to the enactment of Section 27A, the Tenth Circuit had ruled that the Section 10(b) claims of cross-petitioners who invested in Home-Stake's 1970 - 1972 Programs were barred by the one-year limitations period contained in Section 9(e) of the 1934 Act because those investors were placed on inquiry notice by facts relating to the SEC's action against Home-Stake in 1971. The Tenth Circuit ruled that under Section 9(e), an action must be commenced within one year of the date when the investor knows *or should have known* of the facts constituting the violation. That holding conflicts with this Court's decision in *Lampf*, decisions by other courts of appeals, decisions by the district courts, and the legislative history and plain language of Section 9(e). In order to resolve these conflicts, the Court should grant review of this critical issue, which impacts every case brought under Section 10(b) that may be potentially time-barred by Section 9(e). Review is not necessary, however, unless the Court chooses to review the constitutionality of Section 27A, since the Section 10(b) claims of the 1970 - 1972 Classes—the classes affected by this Section 9(e) issue—were found by the Tenth Circuit to be timely under Section 27A.

Section 9(e) provides in pertinent part:

> No action shall be maintained to enforce any liability created under this section, unless brought within one year after the discovery of the facts constituting the violation and within three years after such violation.

In *Lampf*, the Court held that claims under Section 10(b) are to be governed by that provision:

> Litigation instituted pursuant to § 10(b) and Rule 10b-5 therefore must be commenced within one year after the discovery of the facts constituting

> the violation and within three years after such violation.

111 S.Ct. at 2782.

Lampf expressly rejected the notion that Section 9(e) is subject to the doctrine of equitable tolling—that is, that the investor's time begins to run when he discovers, or in the exercise of reasonable diligence should have discovered, the facts constituting the violation:[3]

> [I]t is evident that the equitable tolling doctrine is fundamentally inconsistent with the 1-and-3-year structure.
>
> The 1-year period, by its terms, begins after discovery of the facts constituting the violation, making tolling unnecessary.

Id. at 2782.

In contrast to Section 9(e) of the 1934 Act, the limitations period contained in Section 13 of the 1933 Act, 15 U.S.C. § 77m, provides for both actual and constructive discovery:

> No action shall be maintained to enforce any liability created under section 77k or 77*l*(2) of this title unless brought within one year after the discovery of the untrue statement or the omission, *or after such discovery should have been made by the exercise of reasonable diligence* . . . .

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[3] The doctrine of equitable tolling, as quoted in *Lampf*, states that " 'where the party injured by the fraud remains in ignorance of it without any fault or want of diligence or care on his part, the bar of the statute does not begin to run until the fraud is discovered, though there be no special circumstances or efforts on the part of the party committing the fraud to conceal it from the knowledge of the other party.' *Bailey v. Glover,* 21 Wall 342, 348, 22 L. Ed 636 (1874)." 111 S.Ct. at 2782.

(Emphasis added). In *Lampf*, the Court noted the differences between the 1-and-3-year limitations periods contained in the 1934 and 1933 Acts and expressly held that to the extent those differences proved significant, the language of Section 9(e) governs claims under Section 10(b). 111 S.Ct. at 2782 n. 9.[4]

The Tenth Circuit's original opinion, as amended on rehearing, conflicts with *Lampf* and the plain reading of Section 9(e). In its original opinion, the Tenth Circuit held that under *Lampf*, cross-petitioners' Section 10(b) claims were governed by the limitations period in Section 13 of the 1933 Act. Applying that Section's one-year, inquiry-notice limitations period, the Tenth Circuit ruled that the claims of the 1970-1972 investors were time-barred. It reasoned that those investors were put on inquiry notice by the SEC's litigation with Home-Stake in 1971 and should have discovered the violation of Section 10(b) more than one year prior to the date this action was commenced. (App. 50a).

Supported by the SEC as *amicus curiae*, cross-petitioners sought rehearing. In granting rehearing, the court of appeals clarified its prior opinion, explaining that under *Lampf*, the Section 10(b) claims are governed by the limitations period in Section 9(e) of the 1934 Act. Rejecting cross-petitioners' and the SEC's argument that the one-year period under Section 9(e) begins to run from actual discovery of the facts

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[4] *Lampf* states:

> The Commission notes, correctly, that the various 1-and-3-year periods contained in the 1934 and 1933 Acts differ slightly in terminology. To the extent that these distinctions in the future might prove significant, we select as the governing standard for an action under § 10(b) the language of § 9(e) of the 1934 Act, 15 USC § 78i(e) [15 USCS § 78i(e)].

111 S.Ct. at 2782 n. 9.

constituting the violation, however, the Tenth Circuit held that Section 9(e) requires that the action be commenced within one year of the date when an investor knows or should have known of the violation. (App. 52a-54a). Adopting its previous reasoning under Section 13 of the 1933 Act, the court of appeals held that cross-petitioners' Section 10(b) claims were time-barred. (App. 54a).

In reaching the conclusion that an inquiry notice standard must be read into Section 9(e), the Tenth Circuit relied on the doctrine of equitable tolling (App. 54a, n. 5), precisely that which this Court *rejected* in *Lampf*. Thus, both the Tenth Circuit's conclusion and its reasoning conflict with *Lampf*. As one commentator noted about the Tenth Circuit's application of an inquiry notice standard under Section 9(e), "[t]he first appellate court to consider this question after *Lampf* got it wrong." Johnson, *Securities Fraud and the Mirage of Repose*, 1992 Wis. L. Rev. 607, 623 (1992).

In addition, the decision of the Tenth Circuit conflicts with the opinion of the Third Circuit in *Gruber v. Price Waterhouse*, 911 F.2d 960 (3d Cir. 1990). In that case, the district court had erroneously stated that Section 10(b) claims were governed by the limitations period of Section 13 of the 1933 Act. The Third Circuit clarified that Section 10(b) claims, as decided in *In re Data Access Systems Securities Litigation*, 843 F.2d 1537 (3d Cir.), *cert. denied*, 488 U.S. 849 (1988), were governed by the limitations period contained in the 1934 Act, "which does not provide for inquiry notice." 911 F.2d at 964 n. 4.[5]

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[5] The court in *Gruber* found the district court's error harmless because of its determination that the 1-and-3-year statute of limitations announced in *Data Access* should be applied prospectively. 911 F.2d at 964 n. 4.

There is conflict on this issue within the Second Circuit. That Circuit adopted the limitations period in Section 9(e) in the pre-*Lampf* decision of *Ceres Partners v. GEL Associates*, 918 F.2d 349, 361-64 (2d Cir. 1990), relying on legislative history of the 1934 Act indicating Congress' intent that the one-year period should run from actual discovery. Subsequent to *Lampf*, however, a different panel of the Second Circuit in *Henley v. Slone*, 961 F.2d 23 (2d Cir. 1992) stated that *Ceres* "announced a uniform limitations period of the earlier of one year from the date the fraud was or reasonably should have been discovered . . ." 961 F.2d at 24. Judge Haight in *Werner v. Satterlee, Stephens, Burke & Burke*, 797 F. Supp. 1196 (S.D.N.Y. 1992), cogently summarized the confusion in the Second Circuit and *Henley*'s apparent conflict with *Lampf* and the Third Circuit:

> The issue then is the one-year period from plaintiffs' discovery of defendants' fraud. That means actual discovery, not when plaintiffs might have discovered it by the exercise of due diligence.
>
> Certainly that is the way the Third Circuit articulated the rule in *Data Access*, which the Second Circuit adopted in *Ceres*. As the Third Circuit subsequently pointed out in *Gruber v. Price Waterhouse*, 911 F.2d 960, 964 n. 4 (3rd Cir. 1990), *Data Access* "relied upon the Securities Exchange Act of 1934 which does not provide for inquiry notice." So too in *Ceres*, Judge Kearse's opinion for the Second Circuit looks to §§ 9 and 18(a) of the 1934 Act as source material for the uniform federal limitations periods in securities cases. 918 F.2d at 362. §§ 9(e) and 18(c) both speak in terms of "one year after the discovery of the facts constituting the violation." In *Lampf* the Supreme Court performed the same analysis. . .

> I am therefore respectfully puzzled by Judge Newman's statement in *Henley*, 961 F.2d at 24, that *Ceres* "announced a uniform limitations period of the earlier of one year from the date the fraud was *or reasonably should have been discovered* or three years from the date of the transaction." (emphasis added). I understand the one-year period to run from a plaintiff's actual discovery of fraud, whether or not he should have discovered it earlier.

797 F. Supp. at 1203-04.[6]

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[6] Other district courts, citing *Lampf*, have also applied an actual discovery standard. *See, e.g., Slavin v. Morgan Stanley & Co., Inc.*, 791 F. Supp. 327, 332 (D. Mass. 1992) ("The period of limitation is one year from actual discovery of the fraud .... The defendants' attempt to employ the 'reasonable diligence' standard to toll the limitation period is contrary to the specific guidance issued by the Court in *Lampf*...."); *Hauman v. Illinois Power Co.*, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,882, at 93,606 (C.D. Ill., Aug. 29, 1991) ("Since the one year period in § 9(e) begins to run only when the violation is discovered, the Supreme Court held that tolling is unnecessary. This rationale would not apply if diligence and inquiry notice were relevant considerations... Thus, the language of § 9(e), the relevant case law interpreting that section, and *Lampf* all require that the one year limitation period does not begin to run until the plaintiff actually discovers the facts constituting the violation." (citations omitted)); *In re Digital Microwave Corp. Securities Litigation*, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,044, at 94,596 (N.D. Cal., Oct. 19, 1992) (noting the conflict between the "inquiry notice" standard employed by the Tenth Circuit in this case and the "actual notice" standard employed in cases relying on *Lampf*, the court found the "actual notice" cases "more persuasive").

The legislative history of Section 9(e) also supports an actual notice standard. Senator Fletcher, floor manager of the 1934 Act, explained:

> [T]he thought was that a man ought not to delay suit more than 1 year after he discovers the fraud. If he has been injured and finds that he has been injured, he ought to bring his action within a reasonable time, and we fix that time at 1 year. If he has not discovered it, the person who made the misrepresentation or false statement ought to feel safe at some reasonable time that he will not be disturbed.

78 Cong. Rec. 8198 (1934). *See also* comments by Senators Barkley and Kean which likewise addressed only actual discovery. *Id.* at 8198, 8199, 8201.

An inquiry notice standard is inconsistent with Congress' two articulated rationales for the one-year provision in Section 9(e). First, Congress sought to prevent "investor hedging"—the perceived practice of refraining from filing suit after discovering a violation while waiting to see if the price of the securities goes up. *Id.* at 8199 (remarks by Senator Kean). Second, Congress sought to discourage an investor from holding the threat of suit over the perpetrator's head:

> But if a man discovers within 6 months, or 1 month, after he has been defrauded that he has been defrauded—and he knows it just as well then as he would know it 3 years from that date—it does seem that he ought not to be allowed to let the whole period of the limitation run . . . [S]hould there not be a reasonable limitation upon his power to hold over the opposite party for 5 or 6 years the possibility of a suit?

Id. at 8200-201 (remarks by Senator Barkley).

The two rationales make sense only where the claim is unquestionably known to the investor. An investor cannot engage in "hedging" without being aware of the option to sue, and an investor cannot hold the threat of litigation over a defendant unless the investor knows of the claim. By reading an inquiry notice standard into Section 9(e), the Tenth Circuit undercuts both stated rationales.[7]

This case is particularly appropriate for resolving the conflicting decisions under Section 9(e). The jury, in answers to special interrogatories, specifically found that no class representative discovered his or her Section 10(b) claim more than one year before the action was commenced. (App. 130a-198a). The sole basis for the Tenth Circuit's rejection of those findings was its own determination, as a matter of law, that investors were placed on inquiry notice by the SEC action in 1971. There is no evidence that investors actually discovered the facts constituting the violation of Section 10(b) more than one year prior to commencing suit. If Section 9(e) applies in this case because of the asserted unconstitutionality of Section 27A, then the Section 10(b) judgments of the 1970 - 1972 classes turn in the first instance on the critical difference between actual notice and inquiry notice and the proper interpretation of Section 9(e) and *Lampf*. Accordingly, the Court should consider this question before it addresses the constitutionality of Section 27A.

2. In the Dennler Petition, cross-petitioners have sought review of the decision of the Tenth Circuit holding the Section 11 claims of the 1970-1972 class members time-barred under the one-year limitations period in Section 13 of the 1933 Act. Dennler Petition 13-21. The reasons why that petition should be granted apply with equal force to the pre-

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[7] *See also* Johnson, *Securities Fraud and the Mirage of Repose*, 1992 Wis. L. Rev. 607, 621-23 (1992).

Section 27A decision of the Tenth Circuit regarding claims under Section 10(b) of the 1934 Act. Accordingly, even if the Tenth Circuit correctly read an inquiry notice standard into Section 9(e) of the 1934 Act, the Tenth Circuit improperly found the Section 10(b) claims to be time-barred. The Tenth Circuit ruled as a matter of law that the 1970 Program rescission offer implemented in settlement of the SEC enforcement action placed investors in the 1970-1972 programs on inquiry notice of a wholly distinct fraudulent scheme perpetrated by Home-Stake, where (a) the limited violations of law alleged by the SEC had apparently been cured by the rescission offer prospectus, (b) no other evidence of fraud by the issuer was disclosed or apparent, and (c) the jury specifically found that investors did not discover and could not with reasonable diligence have discovered the fraud until 28 months later. The Tenth Circuit's ruling conflicts with the decisions of other courts of appeals, improperly substitutes its own view of the inferences to be drawn from the SEC enforcement action, and seriously compromises the policies of the federal securities laws. *See* Dennler Petition at 13-21.

A decision in cross-petitioners' favor on this issue would make the Section 10(b) claims of the 1970-1972 class members timely regardless of the constitutionality of Section 27A.

3. Cross-petitioners have also sought review of the Tenth Circuit's holding that the doctrine of equitable estoppel is inapplicable as a matter of law to claims under Section 11 of the 1933 Act. Dennler Petition at 21-28. The reasons for granting review on that issue, which are incorporated herein by reference, apply with equal or greater force to cross-petitioners' fraud claims under Section 10(b) of the 1934 Act. Even if the 1-and-3-year limitations period in Section 9(e) of the 1934 Act is applied to cross-petitioners' Section 10(b) claims, the doctrine of equitable estoppel

renders the Section 10(b) claims of all cross-petitioners timely.

Prior to reaching a constitutional question, all nonconstitutional grounds for decision must first be considered. *Jean v. Nelson,* 472 U.S. 846, 854 (1985). As the Court stressed in *Spector Motor Service, Inc. v. McLaughlin,* 323 U.S. 101, 105 (1944), it should not pass upon questions of constitutionality "unless such adjudication is unavoidable." The district court concluded that cross-respondents were estopped from raising a limitations defense by numerous independent fraudulent acts over the nine years from 1965 to 1973 which prevented cross-petitioners, the SEC, the IRS and the federal courts from discovering various violations of the federal securities laws. (App. 110a-111a). The court of appeals, in conflict with this Court's decision in *Glus v. Brooklyn Eastern District Terminal,* 359 U.S. 231 (1959), and decisions of other courts of appeals construing similar statutes of limitations, incorrectly concluded that the doctrine of equitable estoppel "is not available to avoid the statute of repose established by Section 13 [of the 1933 Act]." (App. 38a). The holding is equally incorrect as applied to the three-year limitations period contained in Section 9(e) of the 1934 Act for the reasons stated at pages 21-28 of the Dennler Petition. Before the Court considers the constitutionality of Section 27A, it should review the equitable estoppel issue, which is dispositive.

CONCLUSION

If the Court chooses to review the constitutionality of Section 27A of the 1934 Act, which cross-petitioners oppose, this cross-petition for a writ of certiorari should be granted as well. The issues raised by this cross-petition should be considered before addressing any constitutional question.

Respectfully submitted,

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